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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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Surging Imports . . .

As expected, the current account deficit for the first quarter of this year was close to the record set in the third quarter of 1984. According to the Commerce Department, the first-quarter deficit totaled $30 billion, the second largest on record after the $32.5 billion deficit for the July through September period of last year. That period, however, included the prime tourist season which takes a heavy toll on the services account. However, since 1982, the year in which the current economic upswing began, the first quarter has posted the lowest current account deficit of any quarter of the year. This suggests that if the past three years are any guide, the $30 billion deficit recorded for this year's first quarter may well be just the tip of a massive red-ink iceberg. Indeed, a simple extrapolation of the first quarter deficit would yield an annual current account shortfall of $120 billion, over $18 billion more than last year's $101.5 billion deficit. Based upon these considerations, and with the continuing strength of the dollar expected not only to sustain high import levels, but also to lure some six million Americans just to Western Europe this year, a current account deficit from $130 to $140 billion seems likely.

In the first quarter, the U.S. also registered a merchandise trade deficit (balance-of-payments basis) of a seasonally adjusted $29.4 billion, exceeding the previous quarter's trade deficit by nearly $5 billion. As shown in the table, this is due almost exclusively to the flood of imports in the first quarter ($85.2 billion), which was not offset to any extent by growth in merchandise exports as it had been in most of the previous quarters since 1982—a grim portent for the future. Merchandise exports last quarter were actually $600 million below the fourth quarter level, due to a decline in agricultural exports—mainly reduced shipments of wheat and other grains which the strong dollar has priced out of world markets.

At the same time, the deterioration of the current account deficit between the fourth quarter and the first quarter was virtually the same as the deterioration of the trade deficit. Neither the net services account nor the unilateral transfers account contributed significantly to the current account balance last quarter. Net service receipts fell by $500 million from previous quarter levels, yielding a small $2.6 billion surplus which failed to compensate for the $3.2 billion deficit arising from such unilateral transfers as foreign aid. The traditional large surplus in the services account has all but disappeared over the past two years as interest payments to foreigners have surged.

SELECTED U.S. INTERNATIONAL TRANSACTIONS
Billions of dollars, seasonally adjusted
(Positive entries are inflows, negative ones are outflows)

Account	IVQ 84	IQ 85
Exports of Goods	56.4	55.8
Imports of Goods	−80.9	−85.2
Merchandise Trade Balance	−24.5	−29.4
Exports of Services	35.1	33.6
Imports of Services	−32.0	−31.0
Services Balance	3.1	2.6
Unilateral Transfers	−4.1	−3.2
Current Account Balance	−25.5	−30.0

Both the trade and current account deficits resulted largely from the burst of merchandise imports in the first quarter. What is more, the fact that imports in the first quarter of this year were 5.4 percent above the previous quarter in spite of lackluster real GNP growth (0.3 percent on a seasonally adjusted annual basis) illustrates that imports are not simply increasing in pace with U.S. economic growth, but are displacing U.S. production at an accelerating rate—perhaps permanently.

. . . Widen The External Deficit . . .

There are three ways by which the estimated $130 to $140 billion current account shortfall (like a household deficit) can be financed—by using savings, by selling real assets and by borrowing. The

DIGEST GOES BIWEEKLY

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"savings" of the United States are its international reserves which, excluding gold, amounted to just over $21 billion in April. Since international reserves, similar to a savings account, are a source of ready foreign exchange as well as an important measure of creditworthiness, countries are reluctant to draw down a large portion of their international reserves except in cases of dire necessity. Gold holdings are defended even more vigorously and, indeed any substantial sale of gold rapidly depresses the price; hence gold sales to raise large quantities of foreign exchange become a self-defeating process. Further, it is unlikely that the U.S. government would use more than $4 or $5 billion from our foreign exchange and gold stocks at most to finance the current account deficit.

Likewise the sale of U.S. real assets to foreigners can be expected to raise only a limited amount of funds to cover the current account deficit. In 1984, net foreign direct investment in the United States was an estimated $22.5 billion. Assuming that foreign direct investment in the U.S. grows by approximately the same amount this year, and that U.S. international reserves are drawn down by about $5 billion, other U.S. borrowing abroad in 1985 may still exceed $100 billion—which, of course, comes on top of the over $70 billion borrowed in 1984. This borrowing will largely take the form of investments in such debt instruments as Treasury and other securities as well as direct loans to U.S. banks, corporations and individuals from abroad. The massive demand for funds from all sources will add substantially to U.S.

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit	6/19/85		
U.S. Gov'ts and Agencies Owned Outright & RPs	174.355	– .658	+10.706
Loans to Depository Inst.	1.427	+ .608	– 1.994
Float	.769	– .257	+ .015
Total Reserve Bank Credit	188.441	– .355	+11.917
Treasury Deposits with Federal Reserve Banks	2.514	+ .437	– 1.567
Currency in Circulation	185.647	+ .095	+11.372
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	122.401	+ 1.575	+ 8.065
	6/19/85		
Member Bank Reserves:			
Total Reserves Held	42.181	+ 1.580	+ 3.993
Excess (Deficiency)	.641	– 160	– .038
Net Free Reserves	.130	– .067	+ .442

Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M1 (6/10/85)	590.6	+ 10.2‡	+ 7.5‡
M2 (May '85)	2,445.0	+ 4.0	+ 8.4
M3 (May '85)	3,077.7	+ 4.8	+ 9.3
Domestic Nonfinancial Debt (1st Q'85)	6,147.0	+ 11.3	+ 13.6

†Seasonally adjusted. *Seasonally adjusted annual rate. ‡Four-week moving average.

New York Money Market

Offering Rates 6/21/85	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	6.97%	7.20%	7.36%
* Federal Agencies	7.40	7.60	7.85
* Municipal Notes–High Grade (46% Taxable Equivalent)	7.41	7.59	8.15
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	7.45	7.75	8.15

‡Finance Company Paper–Prime		‡* Bankers' Acceptances	
5- 14 days	7.25%	Jul.	7.45%
15- 29 days	7.25	Aug.	7.45
30- 59 days	7.25	Sep.	7.45
60- 89 days	7.20	Oct.	7.50
90-179 days	7.20	Nov.	7.55
180-239 days	7.20	Dec.	7.55
240-270 days	7.20		

‡Industrial Paper–Prime			
30- 89 days	7.25%	†Federal Funds Effective Rate	7.40%
90-120 days	7.35		

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	1st Q'85	$ 3,811r	$ 3,759	$ 3,553
Gross National Product (1972 Dollars)*	1st Q'85	$ 1,664r	$ 1,662	$ 1,611
Percent Change, Annual Rate	1st Q'85	0.3r	4.3	10.1
Change in Consumer Prices*	May '85n	2.4%	4.8%	2.4%
Change in Producer Prices*	May '85	2.4%	3.6%	– 1.2%
Civilian Employment (Thousands of Persons)†	May '85	106,960	106,945	105,162
Unemployment as % of Civilian Labor Force†	May '85	7.3%	7.3%	7.5%
Personal Income*	May '85n	$ 3,172	$ 3,189r	$ 2,979
Leading Indicators Composite Index (1967=100)†	Apr '85	167.4	167.7	168.1
Industrial Production Index (1967=100) †	May '85	165.3	165.5	162.8
Net Change in Consumer Installment Credit †	Apr '85n	$ 8.27	$ 8.34	$ 6.79
U.S. Merchandise Trade Balance †	Apr '85	–$ 11.85	–$ 11.05	–$ 11.88
Plant and Equipment Expenditures*	3rd Q'85	$392.61(a)	$385.31(a)	$361.12
Private Housing Starts (Thousands of Units)*	May '85n	1,663	1,927r	1,787
New Construction Expenditures*	Apr '85	$ 325.7	$ 322.4	$ 308.6
Total Business Inventories †	Apr '85	$ 581.3	$ 578.8	$ 545.9
Total Business Sales †	Apr '85	$ 425.7	$ 420.8	$ 408.3

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

obligations abroad. Indeed, it has been estimated that early this year the U.S. became a net debtor nation for the first time since 1914. Further, interest payments alone on the U.S. external debt may exceed $100 billion annually by 1989 if foreign borrowing continues at its present pace—a servicing amount alone nearly equivalent in size to the total outstanding external debt of Brazil, the world's largest developing country debtor!

. . . And Retard U.S. Growth

Clearly the trade deficit which has become virtually the equivalent of the current account deficit has reached proportions where active steps to correct the trade imbalance are imperative. Two factors which might reduce the growing trade and current account deficits are a sharp drop in the foreign exchange value of the dollar, making imports less attractive and/or a further slowing of domestic business activity. But this is not occurring; indeed, the "flash" estimate of inflation-adjusted GNP growth in excess of three percent in the second quarter, suggests that the economic expansion, now in its 31st month, may have been reinvigorated by the recent easing of monetary policy. Nonetheless, the widening net export deficit still exerts an enormous drag on the economy. Had net exports during the first quarter of this year remained the same as in the previous quarter, real GNP would have expanded at a seasonally adjusted annual rate of 4.1 percent, rather than the anemic 0.3 percent rate actually posted. H

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (6/5/85)	155,345	– 262	+ 1,371
New York City (6/12/85)	33,010	– 490	– 884
Commercial Paper (6/12/85)	260,073	– 130	+40,959

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (6/5/85)	254,005	+ 543	+ 10,708
New York City (6/12/85)	61,277	– 517	– 2,544

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (6/5/85)	678,215	+ 7,886	+ 64,283
New York City (6/12/85)	151,147	– 248	+ 13,644

Financial Markets

	Friday 6/21/85	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.22%	+ .38	– 3.11
180-Day Bills†	7.57	+ .40	– 3.84
Longest Bills†	7.90	+ .41	– 4.41
Recent Issues:			
8 1/2s 6/31/87 (When Issued)	8.80	NA	
11 1/4s 3/31/89	9.56	+ .37	
11 1/4s 5/15/95	10.31	+ .41	
11 1/4s 2/15/15	10.57	+ .27	
Municipals:			
Bond Buyer–20 Bond Index* (6/20/85)	8.69%	+ .03	– 1.87
Blue List Total ($ Million)	$2,094	– $ 36	+ $ 980
30-Day Visible Supply ($ Million)	$2,672	+ $403	+ $ 415
Total	$4,766	+ $367	+ $1,395
Corporates:			
Moody's Aa Composite (6/20/85)	11.35%	– .13	– 3.00
30-Day Visible Supply ($ Million)	$1,353	+ $535	+ $1,081
Stocks:			
Dow-Jones Averages:			
Industrials	1,324.15	+ 23.19	+ 193.08
Transportation	649.58	+ 12.64	+ 174.48
Utilities	166.85	+ 2.25	+ 42.48
65 Stocks	546.44	+ 9.51	+ 107.20
Standard and Poor's 500 Stocks	189.61	+ 2.51	+ 35.15
N.Y.S.E. Composite Index	109.84	+ 1.28	+ 20.77
N.Y.S.E. Avg. Daily Vol. for Week (000's)	102,068	+ 4,342	+ 1,076

* 46% Taxable equivalent 16.09%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 6/21/85	Week Ago
Overnight	7.38%	7.25%
1 month	7.44	7.63
3 month	7.63	7.63
6 month	7.88	7.81
1 year	8.38	8.25
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	10.30%	10.10%
Long Term (7 to 15 yrs.)	10.80	10.60

FOREIGN EXCHANGE SPOT RATES

New York Opening (6/21/85)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.01609	62.1500
Canada	.7325	1.3652
Denmark	.09079	11.0150
France	.1063	9.4100
Germany	.3243	3.0840
Italy	.0005077	1969.50
Japan	.004023	248.60
Mexico	.003350	298.50
Netherlands	.2876	3.4775
Switzerland	.3879	2.5778
U.K.	1.2745	.7846

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